or for difficult analyses of expense allocations. Cable operators will not need to justify most rates; franchising authorities will not have to engage in lengthy proceedings to determine if the rates are in fact justified; and there will be fewer occasions to appeal franchising authorities' regulatory decisions.

At the same time, benchmarking will help to assure reasonable rates. Properly-defined benchmarks will serve well all of the goals of the 1992 Act; the rates they permit will be reasonable in relation to the services offered. Because benchmarks will set rates that can be exceeded only if justified, their presence will guide both operators and franchising authorities and eliminate much of the traditional tension between them. The presumptive validity of rates that are equal to or less than the benchmark also will give cable operators an incentive to maintain their rates at or below the mark, if for no other reason than to avoid the time-consuming, expensive process of justifying higher rates.

Finally, benchmarks will give cable operators important incentives to operate efficiently. The inefficient cable operator may have difficulty meeting the benchmark, which will force it through the difficult process of obtaining approval for above-benchmark rates. On the other hand, the efficient cable operator will benefit from streamlined regulation and the opportunities that lower costs provide. Thus, benchmarks will make efficient provision of cable service more likely.

2. The Commission Should Adopt Specific Benchmarking Regulations That Meet The Goals Of The 1992 Act.

While benchmarking is generally a superior approach to rate regulation, it will succeed in advancing the goals of the 1992 Act only if it is carefully designed.[14/] As described below, initial benchmarks should be set according to criteria that make them easy to understand and fair to all parties. Thereafter, benchmarks should be adjusted periodically to account for changes in the costs faced by cable operators,[15/] to cover existing capital obligations and to maintain incentives for future growth. It is also important to give cable operators real flexibility to increase prices that are below the benchmark, so that they can respond to changes in the marketplace and have incentives to improve their service. Rules that recognize these requirements will serve the interests of all parties.

a. Criteria For Setting Initial Benchmarks.

The Commission's first task is to set the initial benchmarks that will apply to basic service on regulated systems. In order for benchmarks to be easily understood and fair to all parties, this process should: (1) set benchmark prices

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14/ The Commission should be cognizant that establishing benchmarks on the basis of rates being charged by systems now subject to effective competition has limited value. It is widely recognized that at the present time systems in overbuild situations do not necessarily reflect a true rate level but, rather, rates which are reflective of immature marketplace conditions. Thus, setting a benchmark on a snapshot profile will provide a distorted portrait of the industry.

15/ Some examples of new costs can be anticipated even now, including expenses necessary to meet new technical standards and the recurring costs of proof of performance tests, or the expenses of new customer service obligations.

on a per-channel basis; (2) exclude franchise fees, sales taxes, and other taxes, fees, and assessments from the calculations; and (3) use a limited number of classifications in determining the appropriate benchmarks for cable systems.

Benchmark prices should be set on a per-channel basis.[16/] The number of channels of basic service offered by cable systems will vary widely, even under the new concept of basic service contemplated by the 1992 Act. The number of broadcast signals and PEG channels will differ substantially from market to market. Systems with especially large numbers of mandatory signal carriage obligations will pose a different situation from those with only three or four channel carriage obligations. In addition, an operator may want to place more than the minimum number of channels on the basic tier. Creating a benchmark that does not take these differences into account would skew the price for basic service on a system and could have other adverse effects.

Next, benchmark calculations for basic services should exclude franchise fees and any other state or local taxes, fees or assessments, including sales taxes.[17/] These will vary widely and their inclusion in the benchmark would confuse and complicate applying benchmark numbers to individual systems.[18/] If

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16/ The measure of the number of channels should be the number of activated channels used to distribute video programming on the basic tier.

17/ Cable operators have no control over these taxes on cable service, a fact recognized by the 1992 Act in the provisions that permit separate itemization of these and other involuntary costs on subscribers' bills. 47 U.S.C. § 542(c).

18/ Excluding these taxes also avoids complications when a single system serves multiple franchises.

these species of fee and tax are included it becomes substantially more difficult to evaluate the reasonableness of requests for above-benchmark rates and complicate later calculation of changes in benchmarks.

Finally, the Commission should be careful to limit the number of benchmark classifications in order to simplify regulatory administration. Many criteria could make it extremely difficult for cable operators and regulators to determine the proper rate per channel for a system. Instead, the Commission should focus on the characteristics that are most important to determining the costs faced by a cable system.

A classification system could be based on (1) the number of channels of basic service provided; (2) the percentage of satellite services among those channels; and (3) whether the system has 1,000 subscribers or more.[19/] These characteristics are among the most important in determining a cable operator's costs and they also are easily determined.[20/] Benchmark classifications that followed this pattern would meet the 1992 Act's mandate for uncomplicated

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19/ In subsequent years other characteristics may need to be assessed, including the availability of non-buy-through pay services, since implementing technological changes to permit access to those services may dramatically affect the costs of basic service. Other factors may have statistical significance even today.

20/ Other criteria which may be of significance might include: (1) the type of plant (coaxial or fiber, one way or inter active); (2) the nature of the terrain; (3) population density; and (4) some accommodation for involvement in research and development.

regulation while assuring that rates are reasonably related to the cost characteristics of each cable system.[21/]

b. Adjustments To The Benchmarks.

Benchmarks once established must not be static. They must change in response to changes in the economic and regulatory environment in which basic cable service is provided. Thus, the Commission should establish adjustments to account for (1) inflation; (2) the costs of providing basic service programming including that which may be created by retransmission consent; (3) changing capital costs; and (4) the costs of any services or facilities required by franchising authorities or other governmental entities, including state cable commissions.[22/] Because most of these adjustments will be individual to each cable system, the Commission should set initial benchmarks and then allow individual benchmarks for regulated systems to vary automatically in accordance

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21/ Using a cut-off of 1,000 subscribers would be consistent with the Act's requirement that the Commission reduce the burdens of regulation on smaller cable systems, especially since it is likely that permitted per-channel rates for small cable systems would be higher than those for large systems. Thus, setting separate benchmarks for smaller systems would reduce the number of small systems that have to seek above-benchmark rates. *See Notice* at ¶ 128, 47 U.S.C. § 543(i).

22/ The state cable commission in New York, for example, has given MSOs providing service in the state five years in which to upgrade all systems to at least 450 MHz; the New Jersey commission followed suit requiring one MSO to upgrade systems to 450 MHz as a condition to approval of a recent acquisition in the state.

with these adjustments.[23/] The adjustments must also be designed to recover not just the direct costs of these changes, but the indirect costs and the opportunity costs, *i.e.* lost profits, from having to use additional resources to cover these costs.

Inflation

Inflation is the one factor that will affect all cable operators and, consequently, the Commission should define a particular inflation adjustment. As was the case when the Commission adopted price cap regulation for common carriers, any inflation adjustment should be based on an easily-obtained, easy-to-understand index. For that reason, the Commission should choose one of the national inflation indices calculated and disseminated by the Federal Government as its inflation adjustment for cable rate benchmarks.

Efforts to create "local" price indices for cable service may be difficult. *Notice* at ¶ 37. First, the calculation of local price indices could be complicated and burdensome. At the same time, any calculation of a local price index might be subject to dispute if the same commodities were available at different prices from different vendors. Finally, any nationally-determined basket of local goods and services is likely not to reflect the actual goods and services purchased in many parts of the country, which would mean that even the best, most accurately calculated "local" index would be no more accurate, on average,

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23/ Unless non-basic benchmark levels also are adjusted the Commission may find itself confronted by complaints over rate adjustments that would otherwise fall within a benchmark were it not for the upward pressure on overall rates occasioned by changes in benchmarks for basic services. This problem can be avoided if other adjustments to basic service benchmarks are automatically incorporated into those for non-basic services. *See* Part III(C), *infra*.

than a national index. The added burden of administering local price indices would simply not be worth the cost.

As is the case for price caps, the Commission should adjust benchmarks for inflation once annually. Annual adjustments smooth out the fluctuations in inflation that occur from month to month and avoid the need for constant adjustments to calculations of allowable rates. Adjustments over some longer period, like two or three years, could make it difficult for cable operators to respond to increasing prices in times of high inflation. Such infrequent adjustments would aggravate the regulatory lag that typically accompanies rate regulation.

Retransmission Consent and Additional Programming Costs of Other Services

Retransmission consent could also be an important, changing factor in the costs of providing basic cable service. Although the legality of the 1992 Act's retransmission consent provision has yet to be determined,[24/] it will have a significant impact on the costs of providing basic service if implemented. Because retransmission consent is a new obligation, the costs of obtaining consent have never been incorporated into the rates charged by cable systems. Whatever the parameters of retransmission consent arrangements,[25/] those costs must be factored into the rates charged for basic service. Otherwise, signals requiring

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24/ *See Turner Broadcasting System, Inc. v. F.C.C.*, No. 92-2247 (D.D.C.) (three judge court).

25/ The Act directs the Commission to adopt rules governing the grant of retransmission consent that conform with the need to ensure that basic service rates are reasonable. *See* 47 U.S.C. § 325(b)(3)(A).

consent will not be carried. Any rate scheme would be arbitrary and unreasonable if it fails to account for costs that will arise **only** because the Congress has specifically provided for the possibility of payment-for-carriage arrangements on basic service. More importantly, designing a rate scheme which fails to take into account an operator's ability to earn a reasonable profit for that level of cable service would be patently confiscatory.[26/] Without the ability to account for retransmission consent, costs, cable operators would be faced with the choice of taking significant losses on the carriage of local broadcast channels or being unable to carry broadcast signals subject to retransmission consent. Rate adjustments for all the costs of retransmission consent, including the administrative costs of negotiating such consents, must be automatic.

Similarly, some cable system operators may choose to place additional satellite-delivered programming services on the basic service tier. In some communities, for example, it may not be economically feasible for the operator to retier services to create an essentially broadcast only tier of service. In order for those operators to offer these additional services to the public on the basic service tier, they must be able to adjust the rates to reflect increased costs that are attributable to carriage of those services.

Changes in Capital Costs

Another important factor is the cost of capital. Changes in these costs can have a serious impact on a cable operator, and may require price

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26/ *See* 47 U.S.C. § 543(b)(2)(C).

changes in order to prevent confiscatory rates. In addition, changes in capital costs are not captured by inflation indices or other possible automatic adjustments because capital costs depend on a variety of factors that are unrelated to changes in the inflation index. As a result, a separate adjustment for capital costs is necessary.

Negotiated Changes

Finally, the Commission should adjust benchmarks to accommodate exceptions to basic service rate levels agreed to by cable operators and their franchising authorities. Cable operators and franchising authorities are permitted under the new law to agree to more stringent (and, likely, more costly) customer service obligations or other services that are not envisioned under current rate structures.[27/] These costs, along with a reasonable return on them, must be reflected in basic rate increases beyond benchmark levels.[28/]

Negotiated adjustments might well be needed for several reasons. A franchising authority might wish a cable operator to take on additional

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27/ A comparable situation might arise where franchising authorities succeed in obtaining waivers of the federal rules on technical standards pursuant to Section 624(e) as amended by the 1992 Act. *See* 47 U.S.C. § 544(e). More stringent standards or testing obligations may so increase operational costs as to warrant benchmark adjustments. Indeed, expenses accompanying implementation of the Commission's recently-adopted technical standards may even warrant upward adjustments to benchmarks as initially applied in some situations.

28/ If rates for basic service are to be kept at reasonable levels, the Commission must include in its regulatory parameters for basic service a clear directive to the cities that additional obligations impose new costs that must be borne by basic cable subscribers and, accordingly, that the cost implications of decisions to impose new burdens must be carefully considered.

responsibilities, like taping and carrying city council meetings and press briefings, function not covered by the original franchise agreement. While the cable operator might normally agree, it might also find itself constrained from doing so by the limitation of its benchmark. Similarly, if new PEG channel requirements are imposed as a part of franchise renewal, the cable operator must be able to recover the new costs, including the underlying costs of capital, that those requirements create. Otherwise, it could find itself unable to continue existing services or programming because of increased costs.

c. Adjustments To Prices Under Benchmarks.

The 1992 Act calls for the implementation of a pervasive regulatory scheme to govern the reasonableness of basic rates. Benchmarks presume the reasonableness of basic rates, but they are not meant to constrain cable operators at any time in their ability to price and market cable services. They cannot be expected to define, for example, how prices can change beneath the benchmark, especially in light of the new environment created by the 1992 Act.[29/]

The 1992 Act is intended to change the way cable service is offered nationwide. The mandate for cost-based equipment prices, the emphasis on a low-cost basic service tier, and many other provisions are going to require cable

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29/ This reasoning is even more applicable to cable programming services, where the Act speaks to jurisdictions, leaving enormous room for Commission discretion in the identification and governance of unreasonable rates. Benchmarks in this context are to be indicators that assist the Commission in addressing complaints; they are not, even presumptively, a limit on what the cable operator can charge. *See* Part III(B), *infra*.

operators to adjust the composition and prices of many of the services they offer to subscribers. Against this backdrop, rules that unreasonably limit a cable operator's ability to price its services reasonably and to change prices to account for congressionally-mandated changes in service would be unfair and inappropriate.

Other changes in the market and in the regulatory environment might require comparable changes in the future. Cable operators that now offer basic service at particularly low prices to benefit senior citizens and the economically disadvantaged may find these practices threatened by current or future changes in the regulatory environment. Particularly low prices for some may remain appropriate, but other pricing practices may be warranted for basic subscribers generally.[30/] Limiting price changes for below-benchmark systems would inhibit such legitimate reactions to changes in the marketplace.

The Commission should not adopt pricing rules that limit how much a cable operator can change its prices below the benchmark. *See Notice* at ¶ 52. "Banding" prices, an approach taken under the common carrier price cap rules, is particularly unsuited to a drastically changing cable marketplace. Five or even ten percent limits on price changes will only hinder cable operators' efforts to comply with the new statutory requirements.[31/]

30/ *See* 47 U.S.C. § 543(e)(1).

31/ The retiering that will result from the 1992 Act also would make it difficult to determine whether a cable operator had complied with banding requirements for individual tiers.

In addition, banding is an inappropriate regulatory choice because it will affect only cable operators whose rates are presumptively **not** unreasonable. While cable operators with rates above the benchmarks may be required to lower their rates in some circumstances, they will still be permitted to charge benchmark rates. Under banding rules, some cable operators would not be permitted to charge rates at the benchmark levels because their past rates were **below** an unreasonable rate level. There is no reason to assume that these operators will now act unreasonably just because of the existence of benchmarks, especially since they have had the opportunity to raise their rates to any level under the 1984 Act and have chosen not to do so.[32/] In other words, banding would have the perverse effect of punishing those operators who have, for whatever reasons, maintained especially low rates.

Banding or other unnecessary restraints on price changes also could have a long term detrimental effect on the quality and diversity of cable service. The installation of fiber optics, addressability, high definition television, programming costs and other, unanticipated technological or market changes may require greater price changes than would be permitted by a banding scheme. Without the ability to finance the equipment and other necessary expenses of improving service, cable television could be unable to compete with new technologies. The Commission can help to prevent this result by giving cable

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32/ Of course, market forces also acted to constrain price increases over the last six years as well, and will continue to do so in the future.

operators flexibility to adjust rates, so long as they remain at or below the benchmark.[33/]

Finally, banding would have the unintended effect of creating disincentives for cable operators that might otherwise invest in new technology. Among other things, this might slow the implementation of the no-buy-through provisions of Section 623(b)(8). *See* 47 U.S.C. § 543(b)(8).

3. Cable Operators Should Be Given Discretion To Demonstrate That Rates That Exceed The Basic Service Benchmarks Are Reasonable.

Benchmarks provide the baseline for identifying cable rates that are presumptively reasonable. Higher rates may be reasonable in certain circumstances. New rules must provide the opportunity to demonstrate that above-benchmark rates are reasonable, based on appropriate evidence.

No matter how a benchmark is derived, in some situations it will not allow reasonableness to be presumed. With an industry so technologically diverse as cable television, and individual marketplaces so dissimilar nationwide, anomalies are guaranteed. This predicament is more of a problem because a pervasive regulatory scheme is being imposed on an industry that has been largely unregulated.

33/ The Commission should reject a "price cap" approach to regulation for similar reasons. *See Notice* at ¶ 49. By setting initial maximum rates at or near each operator's current rates, the Commission would reward bad actors while punishing operators who chose not to raise rates. Price caps also would make it extremely difficult for cable operators to finance rebuilds and upgrades.

As the *Notice* explains, there is a substantial body of case law that prevents regulators from setting rates so low as to be confiscatory. *Notice* at ¶ 33 n.66. While these cases largely derive from utility regulation, the principle remains the same, because any uncompensated taking by government in any business context is unconstitutional. The basic question asked in any "taking" case is whether the government, either directly or by regulation, has taken away the value of the property so regulated. *See, e.g., Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982) (taking occurs where regulation permitting physical invasion renders property unavailable); *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 124 (1978) (interference with investment-backed expectations is a factor in determining if a taking has occurred). Cable operators, just as any other businesses, retain their right not to be deprived of their property.

To avoid inadvertent takings under the rate regulation provisions, the Commission must provide an escape hatch by permitting cable operators to charge above-benchmark rates where those rates are justified. The Commission need not adopt detailed rules outlining what will justify above-benchmark rates. Instead, it should permit cable operators to justify those rates in any appropriate fashion. Among the justifications the Commission should consider are:

(1) Whether the geography or other attributes of the community make service more expensive;

(2) Whether the costs of expansion, rebuilds or upgrades affect the ability of the operator to provide service at below-benchmark rates;

(3) The effects of unusual franchise or state regulatory requirements on the system;

(4) The overall costs of service, as demonstrated by the operator;

(5) Increased capital costs;

(6) Length of franchise;

(7) Environmental considerations; and

(8) Special educational, community service or minority training programs.

The Commission should give special attention to showings regarding customer service, because the 1992 Act places a high priority on meeting customer needs. 47 U.S.C. § 552. Demonstrably excellent customer service, which is not without cost, and other evidence of community service should be permitted to justify above-benchmark rates.

Permitting operators charging above-benchmark rates to justify those rates with appropriate evidence relieves the Commission of the burden of drafting detailed rules.[34/] No body of rules could cover all of the situations in which above-benchmark rates would be appropriate.

While the Commission need not draft specific rules delineating when above-benchmark rates are acceptable, it should, without further inquiry, expressly permit higher rates for non-basic programming services where cable operators and local franchising authorities have agreed that above-benchmark

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34/ The Commission's rules need only specify that cable operators have the right to charge above-benchmark rates upon a showing that those rates are justified.

rates for basic services are warranted. This would significantly reduce the Commission's burden while advancing the 1992 Act's goal of putting more regulatory power into the hands of local authorities.

III. BENCHMARKING APPROACHES SHOULD BE USED FOR BOTH BASIC SERVICE AND CABLE PROGRAMMING SERVICES EVEN THOUGH THEIR RESPECTIVE PURPOSES MAY DIFFER.

Although certain differences between basic service and cable programming services, along with the goals of the 1992 Act, require different approaches to benchmarking, regulation of unreasonable rates for cable programming service can be accomplished by that method as well in a manner that is administratively efficient for regulators, consumers and cable operators.

Nevertheless, some differences in how benchmarking is applied to the two kinds of cable service are needed. Some will be procedural, because of the differing roles of the Commission and franchising authorities under the statute. *See* Part III(B). There also must be some substantive differences, so that the Commission can assure that cable operators have sufficient flexibility to meet their other obligations under the 1992 Act.

A. Benchmarking Is An Appropriate Regulatory Regime For Cable Programming Services.

The Commission may be required to consider different criteria in choosing regulatory regimes for basic and cable programming services, but the factors that lead to benchmarking regulation for basic service also lead to the same regime for cable programming service.

As noted before, benchmarking conserves resources both for the Commission and for the cable operator. Unnecessary rules are especially out of place for cable programming services because of the complaint-driven nature of Congress' regulatory scheme. Benchmarks will allow most complaints to be promptly resolved when the operators' rates are at or below appropriate benchmark levels. Similarly, the advantages of benchmarks over cost-of-service regulation, ranging from enhancing flexibility to providing good incentives, apply equally to basic services or cable programming services. *See* Parts II(A) and II(B)(1), *supra.*

B. Benchmarks Must Be Tailored To The Regulatory Requirements of Cable Programming Service.

While benchmarks can be adapted equally to both basic services and cable programming services, important differences between the two require special benchmarking for cable programming service.

Benchmarks for basic service serve different purposes from benchmark for cable programming service. *Compare* 47 U.S.C. § 543(b) (basic service) *with* 47 U.S.C. § 543(c) (cable programming service). Under the Act, basic rates are regulated directly. As described earlier, the benchmark sets the upper limit and all rates at or below that level are reasonable and, therefore, lawful under the Act. On the other hand, the Commission is not entitled to regulate rates for cable programming, *i.e.*, non-basic, non-pay services. The agency's role is to process complaints alleging unreasonable rates. Benchmarking here has a limited purpose and the Act requires the Commission to consider

many more factors when evaluating cable programming service rates than when regulating the basic tier.[35/]

Second, in order to give cable operators the flexibility to respond to their market, the benchmark for cable programming services should be based on the overall price for **both** basic and cable programming services as well as installation, additional outlets, and equipment rentals. Including basic services in the benchmark calculation for cable programming services allows cable operators to have low-cost basic tiers without sacrificing their ability to provide high quality programming on cable programming service tiers. As discussed above, maintaining a low-cost basic tier is one of the goals identified by Congress. It was not Congress' intent, however, that overall cable service should be adversely affected. Nor should the Commission's regulations have the unintended effect of constraining cable operators' ability to provide the innovative, high quality services that have developed over the past decade. Variations in the scope and quality of services provided on basic will affect even further the pricing components for non-basic services. Congress evidenced a clear preference for shifting some expenses from basic to non-basic services.[36/]

35/ In establishing criteria for determining whether rates are unreasonable, the Commission is to consider elements enumerated in the statute "among other factors." By contrast, its authority to prescribe regulations for the basic service tier is more constrained. *Compare* Section 623(b)(2)(C) *with* Section 623(b)(2)(C).

36/ *See* H.R. Conf. Rep. No. 862, 102d Cong. 2d Sess. 63 (1992) ("Conference Report").

Similarly, cable operators that provide installation and other services at prices lower than those permitted by rate regulations, in order to reduce the cost of basic service, should be permitted to recover those costs through their rates for cable programming service. Below-cost installation provides a positive benefit to the community because it makes cable services more accessible.[37/] Permitting cable operators to recover their lost revenue through cable programming service revenues will create positive incentives to provide this benefit. The Commission should be certain that cable programming service benchmarks do not constrain the operator's ability to package and market services to meet local subscriber needs, so long as overall rates do not rise to unreasonable levels.[38/]

C. Benchmarks For Cable Programming Service Should Be Adjusted In Accordance With The Characteristics Of That Service.

Just as the Commission must tailor cable programming service benchmarks to account for differences between basic and non-basic services, it also must assure that adjustments to cable programming service benchmarks take

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37/ For instance, CVI rarely prices installations at a level designed to recoup all all of its costs; reduced price installations are often available under marketing promotions.

38/ In addition, the Commission should not regulate the provision of audio services over cable television facilities. The market for the provision of audio services is highly competitive, and there is no evidence that it is necessary to impose any regulation whatsoever on these services. Bulk pricing and prices of services provided under contract to schools, institutions and multi-dwelling units also should not be regulated. *See* Part VII(F), *infra.*

the characteristics of that service into account. Some of the necessary adjustments will be the same as those applied to basic service, others will be pass-throughs of adjustments to basic service and some adjustments will be specific to cable programming service.

First, some of the adjustments that apply to basic services should also extend to cable programming services. As discussed in Part II(B), *supra*, these include inflation and the costs of capital. These adjustments affect cable programming service in the same way as basic service and should, therefore be applied in the same way to both benchmarks.

Other cost changes, like increases to reflect the added costs for such elements as retransmission consent, customer service and other changes approved or mandated by franchising authorities, should be incorporated directly into the cable programming service benchmark on a system-specific basis. These costs must be included in the cable programming services benchmark in order to assure that the cable operator can recoup them.

Finally, the benchmarks for cable programming service must be adjusted to account for changes in costs that directly affect cable programming service. The most obvious of these are changes in the costs of obtaining programming. These costs should be passed directly through into the benchmark, with an additional margin to account for a reasonable profit.

It also is vital that benchmarks for cable programming service be adjusted to account for rebuilds, upgrades and system expansion. Improvements in cable service often come at considerable cost, in new equipment, new

transmission facilities, or other improvements. If cable operators are to continue the technological and other progress described in Part I(A), they must be able to modernize their facilities and expand them to serve areas that currently have no cable service. Consequently, benchmarks should be adjusted to account for these costs and a reasonable profit on the investment.[39/]

This adjustment should not consist merely of shifting an operator from one benchmark category to another if it constructs additional channels. Indeed, such a shift might actually penalize the operator for its new construction. Instead, the Commission should allow cable operators to increase their benchmarks when they have made capital expenditures, using a simple, uncontroversial formula which includes a return on the investment.

Once the adjustment is made, it should, like all other adjustments, become a permanent part of the operator's benchmark for that system. Its performance will help to create incentives for cable operators to improve and expand their systems for the benefit of cable subscribers nationwide. Future adjustments must also take into consideration the costs of on-going investments. Operators often make substantial capital investments in system facilities and arrange a debt repayment schedule or equity financing terms that envision a series of rate increases spread over a period of time. Certainly operators cannot be penalized for arranging to keep cable rates lower in the short term, but increased gradually over a period of years. Indeed, financing arrangements of

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39/ New programming services that may become available should also be included in the factors warranting adjustment.

this kind are commonplace and have enabled operators to respond to franchisor requests for the latest in cable technological achievements. Today cable subscribers are enjoying the benefits of those investments even though recovery of much of the costs incurred by the operators has been deferred and cannot be recouped if cable rates are to remain largely static over time.[40/]

D. Cable Operators Should Be Given Discretion To Demonstrate That Rates That Exceed The Cable Programming Service Benchmarks Are Not Unreasonable.

Benchmarks for cable programming service will serve, in large part, to tell the Commission when further inquiry regarding a complaint is warranted. This limited purpose makes it particularly important that the Commission give cable operators the chance to show that above-benchmark rates for cable programming service are not unreasonable.

The Commission should consider a variety of factors in deciding whether an above-benchmark rate for cable programming services is unreasonable. Among the factors that should be considered are those listed in Part II(B)(3), above, including the geography of the community, unusual franchise requirements and a reasonable return on capital costs. These factors affect both basic and cable programming service. The Commission also should consider

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40/ Because non-basic cable services have never before been a proper subject for regulatory oversight, *see, e.g., Community Cable TV, Inc.*, 95 F.C.C.2d 1204 (1983), operators have been at liberty to design debt repayment and other capital schedules to accommodate perceived subscriber needs and interests. The late onset of regulation should not upset those financial arrangements nor deny an operator a reasonable profit on that investment.

factors that relate specifically to cable programming service, including any substantial increases in programming costs, the costs associated with rebuilds, and the costs of new services being provided to cable subscribers.

The Commission should also give cable operators that use costing analysis the discretion to make those showings in any appropriate fashion. The Commission should accept cost sampling and other means of making reasonable approximations of the operator's costs. It should not, however, require detailed cost information of the kind that common carriers are typically required to provide. Producing that kind of voluminous data to resolve a complaint is totally unnecessary.

IV. THE COMMISSION SHOULD ADOPT REGULATIONS FOR EQUIPMENT, INSTALLATION AND CHANGES IN SERVICE THAT ARE EASY TO ADMINISTER AND PROTECT BOTH SUBSCRIBERS AND CABLE OPERATORS.

The 1992 Act also mandates the regulation of prices for equipment, installation, and changes in cable service. 47 U.S.C. §§ 543(b)(3), (5). In general, these charges are to be based on "actual costs" for subscribers to the basic tier of service. *Notice* at ¶¶ 62, 74. Regulations for these rates should reflect all costs (both direct and indirect) and a reasonable profit,[41/] and should be easily-understood in order to simplify enforcement and compliance by affected parties. In keeping with the underlying theme of the Act that there be no

41/ *See* 47 U.S.C. § 543(b)(2).

regulation in the presence of effective competition, the Commission should exempt from regulation any equipment that is available commercially.[42/]

A. The Rates For Cable Equipment Should Be Based On Average National Equipment Costs.

While the 1992 Act mandates cost-based regulation for equipment, traditional cost-based regulation would be too complicated and too uncertain to justify its use for cable equipment. *See* Part II(A), *supra*. Instead, the Commission should base the rates for cable equipment on national averages, much like the benchmarks it should adopt for cable service.

The starting point for this regulation is to establish the types of equipment that are available. There are essentially four variations at this time: (1) regular converters; (2) regular converters with remote controls; (3) addressable converters; and (4) addressable converters with remote controls. To establish the cost-based rates for these variations, the Commission should survey vendors to establish the average cost for each type of equipment, including freight charges and taxes.[43/] The average cost per converter should then be adjusted to account for (1) the non-return rate when service is disconnected; (2) the cost of repairing broken equipment; (3) the cost of collecting equipment when service is disconnected; (4) inflation; (5) the cost of capital; (6) other allocable costs, including capital costs; and (6) a reasonable profit, as required by the statute.

42/ Universal remote units, for example, are readily available nationwide.

43/ The Commission should establish several averages for each equipment type, since costs vary depending on the size of an order and other factors.

47 U.S.C. § 543(b)(2). The total of the cost and these other factors should be divided by the useful life of the equipment to determine the benchmark rate.

This benchmark approach will permit cable companies and franchising authorities to determine the maximum charge for basic service tier equipment without elaborate, system-specific cost calculations. It also will assure that cable operators are able to recoup their "actual costs" for providing equipment, including indirect costs and a reasonable profit, as mandated by the statute.[44/]

B. The Commission Should Adopt Regulations That Control Only The Maximum Price For Installation Of Basic Service.

The provisions of the 1992 Act require the Commission to adopt rules for cost-based pricing for basic cable service installation, but do not specify the mechanism to achieve that goal. 47 U.S.C. § 543(b)(3). The Commission should allow cable operators the flexibility to charge promotional and other below-cost rates for cable installation, so as to preserve their ability to attract new customers and expand their businesses.[45/]

44/ Alternatively, if system-specific calculations are pursued, cost calculations for each system must include: (1) the direct cost of, among other things, materials, fully-loaded labor, maintaining inventory, repair, purchasing, centralized fleet management, addressable equipment subscription fees, property tax, insurance, non-returned equipment, recovery of equipment and billing; and (2) indirect costs, including administration, audit fees, interest, internal accounting, legal fees and marketing.

45/ As described in Part III(B), *supra*, cable operators should be permitted to recover their losses on below-cost installation through their rates for cable programming service.